



ABABA UNIVERSITY

SCHOOL OF GRADUATE STUDIES

COLLEGE OF LAW AND GOVERNANCE

SCHOOL OF LAW

**The Desirability of Introducing a Two-Tier Board Structure in the
Ethiopian Corporate Governance System**

By

Daniel Tariku Tamiru

April, 2020

ADDIS ABABA, ETHIOPIA

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Corporate Governance System**

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**A Thesis Submitted in Partial Fulfillment of the Requirements of the LLM Degree
(Business Law)**

April, 2020

Addis Ababa, Ethiopia

DECLARATION

I, the undersigned, hereby declare that this thesis is my original work, has not been presented for a degree in any other university or institution and that all sources of materials used for the thesis have been duly acknowledged.

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Table of Content

Contents	pages
Acknowledgement	<u>I</u>
Abstract	<u>II</u>
List of Acronyms	<u>III</u>
Chapter-one	1
1. Background of the Study	1
1.1 Introduction.....	1
1.2 Statement of the Problem.....	3
1.3 Research Question	4
1.4 Objective of the study	4
1.4.1 General objective	4
1.4.2 Special objective	4
1.5 Significances of the Study	5
1.6 Scope of the Study	6
1.7 Methods/Methodology	6
1.8 Organization of the Study	7
Chapter-Two	8
2. Overview of Governance System and Standards of Share Companies	8
2.1 Significance of Corporate Governance.....	8
2.2 International Initiatives and Principles of Corporate Governance.....	9
2.2.1 OECD Principles of Corporate Governance	10
2.3 Modes of Corporate governance.....	13
2.3.1 One-Tier (Unitary) Board Structure.....	13
2.3.2 Two-Tier Board Structure.....	14
Chapter-Three	17
3. Corporate Governance and the Structure of Board of Directors in Ethiopia Share Companies	17
3.1 Existing Governance Regulation and Supervision of Share Companies in Ethiopia	17
3.2 Role and Responsibility of Board of Directors in the Corporate Governance of Share Company	18

3.2.1 Calling Shareholders’ Meeting and Setting its Agenda	20
3.2.2 Appointing and Dismissing the Chairman, the Chief Executive Officer and Deputy Chief Executive Officers	22
3.2.3 Supervision of the Management	24
3.2.4. Determination of the Annual Accounts and Reports its Action in the Annual Report	25
3.3 Challenges of the Existing One-Tire Board Structure Under the Commercial Code	26
3.3.1 Conflicting Role.....	26
3.3.2 Independence of Board the of Directors	27
3.3.3 Board at the Intersection	28
Chapter-Four	30
4.The Desirability of Introducing a Two-Tier Board Structure in the Ethiopian Corporate Governance System	30
4.1. Structure of Two-tire Board Model	30
4.1.1 The Management Board.....	30
4.1.2 Supervisory Board.....	31
4.2. Evaluation of the Two-Tier Board Structure (pros’ and cons’).....	32
4.3. The Desirability of Adopting the Two-Tier Board Structure as Solution to the Problems in the Ethiopian Share Company Corporate Governance.	34
4.4. Prospects and Challenges of Introducing the Two-Tier Board of Directors in The Governance of Ethiopian Share Companies	38
4.5 Matters that Needs Consideration in Introducing Two-tier Board of Directors in Governance of Share Companies in Ethiopia	40
Chapter-Five.....	42
5.Conclusion and Recommendations.....	42
5.1 Conclusion	42
5.2 Recommendation	44
Bibliography	45

Acknowledgement

Above all, I am grateful for the almighty God for giving me all the strength and persistence to finish this work.

I am especially indebted to my advisor Dr Solomon Abay (Associate Professor) for his insightful and constructive comments throughout the preparation of this paper. I would also like to express my deepest appreciation to Ato, Jirata Nemera and W/ro Feven Mulat, for their unreserved cooperation and assistance with the collection of my data.

Finally, I would like to extend my heartfelt gratitude to family and friends who give me love and encouragement.

Abstract

The board of directors could be an exceptionally complex organ considering its source and reasons for presence, board members' connection to the corporations, shareholders and officers, and board's function and models. In the corporate world, there are two predominant board of structures namely a Two-tier board (dual-model) and the One –tier board (unitary model) structure which Ethiopia follows currently. The two-tier board structure composed of the supervisory board and managerial board whereas in the former one it unifies both i.e. the managerial and supervisory board. A certain company has to be fulfilled with a well-governed and well-functioning effective board of directors to become successful. Accordingly, In Ethiopia, these days, the general public, as well as the business community, begins to come out from the cubicle approach and engages in share companies that require collaboration and a large investment. The numbers of share companies that are being formed are dramatically increasing. However, the current board of directors' governance laws are being detached with several gaps and the very updated principles of corporate governance are not included in the code and other subsequent legislation. Accordingly, this study is concerned to examine the shortcoming of the two systems in terms of benefiting the viability of the company, shareholders, management's, employees, and also society in general. This study will also further analyze whether the Ethiopian corporate legal system should introduce the two-tire board structure or not.

List of Acronyms

Art	Article
Civil Code	Civil Code of the Empire of Ethiopia
Commercial Code	Commercial Code of the Empire of Ethiopia
CEO	Chief Executive Officers
FDI	Foreign direct investment
MoT	Ministry of Trade
NBE	National Bank of Ethiopia
OECD	Organization for Economic Co-operation and Development
CACG	Commonwealth Association of Corporate Governance
UN	United Nation
UK	United Kingdom
US	United States
ICGN	International Corporate Governance Network
MOA	Memorandum of Agreement
WTO	World Trade Organization

Chapter-one

1. Background of the Study

1.1 Introduction

Recently, the issue of corporate governance has gathered much more attention from companies and investors to government authorities, organizations and securities exchanges across countries. There are several reasons for this attentiveness. The major reasons as research indicates are: having better corporate governance frameworks in their system which would benefit companies through greater access to financing, lower cost of capital, better business performance, and more favorable treatment of all stakeholders.¹ And, this gives the corporations great incentives to establish and maintain a good mechanism of a corporate governance structure for business operation. There is some evidence that good corporate governance prompts direct economic benefit to the organization.²

Furthermore, when we talk about Corporate Governance, we mean about systems that govern the relationships between a company and its internal and external stakeholders.³ The capital markets can be considered as external while the board of directors cited as an internal corporate governance mechanism. One of the rationales behind establishing good Corporate Governance in the company is to ensure the sustainable growth of companies through promoting governance systems that put companies and their various stakeholders in a win-win situation.⁴ This is what ensures the sustainability of the business in today's rapidly changing and competitive market place. The central essence of Corporate Governance is nothing but effective leadership. The leadership in this context is not ruling but making decisions in the best interest of the organizations and corporate citizens around them.

¹ See Stijn Claessens, Corporate Governance and Development, Global Corporate Governance Forum, 2003, available at [http://www.gcgf.org/library/Discussion Papers and Focus%20Notes/Focus 1 Corp Governance and Development.pdf](http://www.gcgf.org/library/Discussion%20Papers%20and%20Focus%20Notes/Focus%201%20Corp%20Governance%20and%20Development.pdf).

²For instance, the guideline that has been prepared by the ECA in response to a request by the Heads of State and Governance Implementation Committees (HSGIC) in 2002, stipulate that the importance of good corporate governance goes beyond the interest of the owners and/or shareholders of individual companies. It contributes to the efficient mobilization and allocation of capital, the efficient monitoring of corporate asset, the effectiveness of overall corporate performance and improved national economic performance. Available at <http://repository.uneca.org/bitstream/handle/10855/5544/Bib-39457.pdf>.

³ Cited above at note 1.

⁴ Frederic D Lipmann and Lee Keith Lipmann Corporate governance; best corporate practices; John Wiley and Sons LTD (2006), Page 1

However, nowadays the fundamental problem of corporate governance can be traced back to what is known as the “separation theory” which proposed by Adolf Berle and Gardener Means, well-known by the work of “The Modern Corporation and Private Property”. The authors articulate that, in the modern corporation, there has arisen a ‘separation of ownership by a passive shareholder from control by small self-perpetuating management group’. The small group of managers is relatively free to manage the publicly held corporation as they deem fit (for their own benefit), not that of the powerless and passive shareholders. They also proffer that, there is a significant divergence of interest between ownership and control of the modern corporation. As a result, one of the main concerns that have been addressed by modern reform initiatives is the independence of the board of directors.⁵ There is little doubt about the primacy of this condition. It is normally acknowledged that an “absence of observing by autonomous, impartial non-executive directors [...] has been a significant reason for the different corporate embarrassments that have been seen.”⁶

Corporate governance has been defined differently by numerous scholars. The variation in these definitions stems primarily due to differences in perspectives regarding the ambit of corporate governance. In the economics perspective as Andrei Shleifer and Robert Vishny, define corporate governance as the manners by which providers of investments to companies guarantee themselves of getting a return on their venture.”⁷

Other authors, such as Robert A.G. Monks and Nell Minow, enroll more of political approach, with regard to defining corporate governance as the connection of “*directors, managers, shareholders, employees, customers, creditors and suppliers . . . to the corporation and to one another.*”⁸

The OECD also gives a comprehensive definition of corporate governance.⁹It characterizes corporate governance as being a factor for economic productivity and development. Besides, it

⁵ High Level Group of Company Law Experts (2002). “A modern regulatory framework for company law in Europe”, report of the High-Level Group of Company Law Experts, 4th of November. p.60. Available at: http://europa.eu.int/comm/internal_market/en/company/company/modern

⁶ In US for instance the Enron, WorldCom and Ahold companies’ scandal can be mentioned due to the fact that most major fraud and bankruptcy cases were occurred by having lack of corporate governance.

⁷Shleifer, A., & Vishny, R. W. (1997). A survey of corporate governance. *The Journal of Finance*, 52 (2), 737-783. 52J.

⁸ Robert A.G. Monks & Nell Minow, Corporate Governance 8 (1995).

⁹ Organization for Economic Co-operation and Development (OECD), ‘OECD Principles of Corporate Governance’, [2004] pp.11 (preamble). available at: www.oecd.org/dataoecd/32/18/31557724.pdf.

helps in improving shareholder's confidence. Corporate governance is the interrelationship between the company and its stakeholders and functions as an internal control mechanism for achieving the company's objectives.¹⁰ In the same manner, the National Bank of Ethiopia, has define "Corporate governance" for banks as "the process and structure used to direct and manage the business and affairs of a bank towards enhancing business prosperity and corporate accountability with ultimate objectives of realizing long term shareholders' value as well as customers and other stakeholders' interest".¹¹

In summary, for purposes of this research, corporate governance involves the separation of ownership, control and functions as a mechanism in place to safeguard that management still manages the company intending to obtain benefits for the investors. It addresses, on one hand, the principal-agent relationship between shareholders and directors and on the other hand the relationship between company agents and stakeholders.¹² As we know Share Companies always have relationships with their stakeholders such as shareowners, customers, suppliers, employees, regulators, and local communities.¹³In other words, all parties that have an interest in the success of the company.¹⁴Hence, it would be difficult for Share Companies to stay in business if they are not managed in the interests of these key groups.¹⁵

1.2 Statement of the Problem

In light of the above assertion in Ethiopia, there are several gaps and the very updated principles of corporate governance are not included in the code and other subsequent legislation. For instance, the manner how share companies are going to be governed, how the board of director are gonging to direct a certain corporate without misleading its ultimate goal or protection of the stakeholder's interest at large. In addition to that the Commercial Code is also hated by not having a clear provision regarding who monitor, and oversee all activities of the company are not being adequately stipulated. Indeed, there is an attempt that has been implemented in the financial sectors concerning conveying better corporate governance framework legislation for companies that

¹⁰ Ibid.

¹¹ Bank Corporate Governance Directive No. SBB/71/2019 (1st replacement), Art 2.3

¹² Cited above at note 9.

¹³ Donaldson, T., & Preston, L. E. (1995). The stakeholder theory of the corporation: Concepts, evidence, and implications. *Academy of Management Review*, 20 (1), 65-91

¹⁴ Ibid.

¹⁵ Cited above at note 6.

operate in this sector in Ethiopia.¹⁶ And it can also understand that the governance and regulatory framework in the financial sector are prudential which leaves them under strict supervision and control of the National Bank of Ethiopia.¹⁷ The statutory governance bodies, especially the board of directors, in the banking, insurance companies or microfinance institutions are elected according to the criteria put or formulated by the National Bank.¹⁸

Despite the fact that the national bank tries to create a well-performing financial sector, there are still companies that operate in the non-financial sector especially share company governance, laws are very weak and the Commercial Code lacks rules that are not in line with the modern comprehensive and effective corporate governance rules. As a result of this, examining the sufficiency of the current controlling mechanisms(one-tier), and looking into the vitalities of introducing the dualistic model (two-tier) board structure to the Ethiopian corporate governance system due to its clear separation between the management board and the supervisory board as a tool for good corporate governance in Ethiopia will be seen.

1.3 Research Question

Based on the above problems the research will try to answer the following specific question

- 1) The legal position and challenges of Ethiopian share company corporate governance looks like?
- 2) Should a two-tier board structure ought to be introduced in the Ethiopian corporate governance system?

1.4 Objective of the study

1.4.1 General objective

The overall objective of the research is to have a thorough understanding of the concept of corporate governance in general and try to grasp an idea with regard to share company corporate governance of Ethiopia look like.

1.4.2 Special objective

The specific objectives of this paper include ascertaining the modes of corporate governance, exploring its role in promoting good corporate governance, examining the rules of foreign

¹⁶Banking Business Proclamation, Proclamation No. 592/2008, Federal Negaret Gazeta No.57 and microfinance Business proclamations, proclamations No. 626/2009, Insurance Corporate Governance Directive No. SIB/42/2015.

¹⁷ Ibid.

¹⁸ Id, Article 14.

jurisdictions regulating the two-tier board of corporate governance, and further analyze whether the Ethiopian corporate legal system should introduce the two-tier board structure or not.

1.5 Significances of the Study

The reason behind researching this specific area is that Ethiopia is one of the fastest-growing economies and according to the national bank of Ethiopia forecasts in which economic growth will expedite to 10.8%¹⁹ for the fiscal year summing-up in July stimulated by its reforms, from 9% in the previous year.²⁰

Furthermore, it's a fact that the Ethiopian government is currently designing its policies to attract more foreign direct investment (FDI) into the country, restructuring the economy by launching "Home Grown Economy Reform Program", and one of the reform agenda is the privatization of state-owned enterprises for instance: the ongoing privatization of the sugar plant industry sectors can be mentioned. In this regard the government believes the proper implementation and governance of the recently launched homegrown economic reform program are expected to contribute towards developing a modern, vibrant, competitive and sound financial system. And it is also visible that there is a remarkable increase in the number of share companies and their potential contribution to the Ethiopia economy. As a result, this research will focus on examining issues related to corporate governance in Ethiopia with that of introducing the Two-tier Board structure in corporate governance and its consequent impact on the efficacy of share companies. Additionally, it will assess the desirability and undesirability of introducing the Two-tier Board structure in corporate governance of Ethiopian share companies in the view of national laws and practices as well as different theories, research works, foreign country experiences, and international documents.

Further, this study will possibly recommend the way how Ethiopian corporate governance should be introduced and integrated with the notion of the two-tier board structure in the corporate governance system of Ethiopian share companies. Nevertheless, except for the efforts of a few scholars, the problem remains highly unexplored in Ethiopia. Therefore, this study will also serve

¹⁹ Even if the Ethiopian government estimates this projection for 2020, the world bank however, cuts its forecast to 6.3% of the fiscal year which is way below the government projection. The lender reduced its fiscal 2020 growth forecast for Ethiopia by 1.9% points from the prior estimate in June. Growth could increase slightly to 6.4% in fiscal 2021 and 7.1% in 2022, according to the world bank. In addition, the Economist Intelligence Unit (EIU) forecast Ethiopian GDP growth of 2020 to 7.4% which is closest to the world bank projection.

²⁰<https://www.bloomberg.com/news/articles/2020-01-07/ethiopian-central-bank-sees-2019-20-gdp-growth-rising-10-8>. Last assessed in January 08-2020.

as a basis and may call the attention of those who want to conduct further research on the subject matter.

Also, the study will help policymakers, legislators and regulators beware of the nature of the problem and the limitations of our laws in responding to the problem. It will help them make informed and proper policy and legal reforms. It will also have significance for shareholders and other stakeholders in companies in understanding the problem and knowing the successes and limitations of the legal remedies available. The study could also be of some use for lawyers, and academics.

1.6 Scope of the Study

As mentioned earlier, the research will evaluate the desirability of introducing a Two-tier Board structure in the corporate governance of the Ethiopian share company. Therefore, the research is all about share companies engaging both in financial or non-financial activities and more specifically about the composition of the board of directors. Additionally, it will evaluate if its recommended for Ethiopian share companies to be composed of the two-tier board structure too; rather than being consisted of a single board system only. Moreover, the study delimited its scope to effective corporate control and directed. The research will also try to address issues related to the manner of integrating and introducing the two-tire board structure and also examines whether the Ethiopian corporate legal system should introduce the two-tire board structure or not.

The experiences of some selected foreign countries on the issue of directors in share companies are made part of the research. Therefore, the experiences of Germany, China, Great Britain, have been dealt with but not in a comparative way. International principles such as OECD are also part of the study. The research, for the purpose of clarification, also came across concepts such as corporate governance and its types, modes of corporate governance and board of directors both internationally and in Ethiopia as well. However, geographically the research is limited to share companies situated in Addis Ababa.

1.7 Methods/Methodology

This thesis is designed in a way that allows the writer to describe the basic essence of corporate governance in Ethiopia. Thus, in terms of research design, the thesis will be undertaken descriptively by employing descriptive study techniques and methods. For this purpose, the most appropriate and effective methodology to be applied for the conduct of the research is a qualitative

approach. Therefore, the thesis is more of an empirical legal study. As a result, to achieve its objectives, the writer will employ both primary and secondary data collection methods.

Primary data- direct or unstructured interviews with relevant bodies, in the MOT, the NBE, officers in the financial institutions and legal practitioners are made part of the interview. This helps to clarify and deliver clear insight about the practice as a result of their familiarity and venerable to the subject matter. In addition, personal observations and analysis of legislation will be used.

For secondary data, the writer will review research reports, published and unpublished materials like books, journals, domestic and foreign legislations, newspapers, magazines, and other relevant publications will be deployed. In particular, internationally recognized best practices and principles of corporate governance, such as that of the OECD will be consulted. The writer has opted to use the OECD Principles for three main reasons. First, the OECD principles have been obtaining wide-ranging acceptance with in the international arena for long time plus they also have been saluted for providing a minimum standards and practices of sound corporate governance framework.²¹Second, they provide the experience of not only OECD countries but also non-OECD countries as a whole to formulate and ameliorate their legal, regulatory and institutional framework for proper corporate governance by talking into account their national economic, social and business practices.²² Third, they mainly focus on the governance problem that results from the separation of ownership and control and the relationship between shareholders and management which is also the main concern of this research.²³

1.8 Organization of the Study

The study encompasses five chapters, the first chapter comprises the proposal of the research and it includes background of the study, meaning, statement of the problem, research questions, the objective of the study, scope of the study, the significance of the study, methodology, and organization of the study. The second chapter covers the Overview of Governance System, Standards of Share Companies and Modes of Corporate governance will be covered. Goes to third chapter, which look into the Current Share Companies Corporate Governance and the structure of Board of Directors in Ethiopia. The fourth chapter will look in too the desirability of Two-tier

²¹ Cited above note 9.

²² Louis Bouchez, 'Principles of Corporate Governance: the OECD Perspective' (2007) 4(3) European Company Law 109.

²³ Cited above at note 9.

Board Structure as a solution to the problems. Lastly, the Conclusion and Recommendation will be given based on the whole discussion.

Chapter-Two

2. Overview of Governance System and Standards of Share Companies

2.1 Significance of Corporate Governance

Good corporate governance nowadays is fetching as vital in this fast trending economic activity throughout the globe.²⁴ As a result of this, several countries are endorsing their policymakers, companies, shareholders, and investors to make a reform by being aware of its significances to the economy²⁵, Which also resulted in getting the attention of various scholars and popular presses across the world.²⁶ Moreover, Adopting effective corporate governance will help to set a system that guides the relationship between owners, boards, managers, and various stakeholders, clarifying the rules and procedures for making decisions on corporate affairs, by whom the decisions should be made and how they should be implemented.²⁷

The presence of well-performing corporate governance, will support to ensure the interest of every stakeholder including the potential investors by offering premium price,²⁸ companies with higher access to finance and reduction of risks resulting in improved profitability,²⁹ the public sector through the development of the stronger capital market, increased investment, and high economic

²⁴Cited above at note9, see also Ashenafy Beyene Fanta, Kelifa Srmolo Kemal and Yodit Kassa Waka,” Corporate governance and impact on bank performance,” Journal of Finance and Accounting, Vol.1, No.1(2013), p.1

²⁵ OECD

²⁶ Fekadu Petros, Ethiopian Company Law (Fareast Trading: Addis Ababa, 2012), p.51

²⁷ Effective corporate governance means that transparency values exist, investors receive timely and relevant information, decision-making is not done secretly, decision-makers are held accountable for their actions, there is tightened internal controls and financial reporting and managers/directors act in the interest of a company and not their personal interests. (Hontz E and Shkolnikov a Corporate Governance: The Intersection of Public and Private Reform (Center for International Private Enterprise 2009) 29 available at www.cipe.org/sites/default/files/publication-docs/CG_USAID.pdf(accessed on 20 January 2020)).

²⁸ Recent research works also reveal that investors are more interested to invest their capital in share companies that practice good corporate governance and have good reputation. See Frederick D. Lipman and L. Keith Lipman, Corporate Governance Best Practices: Strategies for Public, Private, and Not-for-Profit Organizations (New Jersey: John Wiley & Sons, Inc., 2006), p.3

²⁹ Sound corporate governance practices have marginal advantage in attracting international capital because they set clear minimum standards of responsibility, governance, inspection and thereby produce a lower market risk. See. Lutgart Van den Berghe and Liesbeth De Ridder, International Standardization of Good Corporate Governance: Best Practices for the Board of Directors (Springer Science+ Business Media Dordrecht, 1999), p.17

growth, and it will also widen the business affiliation among the stakeholders, which is found to be the main pillars of good corporate governance under the OCED.³⁰

Last not least, practicing good corporate governance helps to prevent corporate scandals and frauds, and maintain financial system stability.³¹ In fact, Poor corporate governance can weaken a company's potential, can lead to financial difficulties, and in some cases can cause long-term damage to a company's reputation.³² However, developing countries are now working to advancing their corporate governance as the threat to global financial markets has risen. But there are countries especially the small and the poor ones that have given little attention to corporate governance till now, including Ethiopia.³³

2.2 International Initiatives and Principles of Corporate Governance

Generally, it has become well established that, to strengthen companies, whether they are private or public entities, there must be a continual venture of capital injection and human resources as well as customer satisfaction and public confidence within the entities.³⁴ To be able to attain these objectives, companies need to do more than just create a track record of producing goods and services and having a reasonable market share, however, they should have precise and effective management and they need to be perceived to be properly governed.³⁵ Internationally, these initiatives are being spearheaded by multilateral organizations including the World Bank,

³⁰ Cited above at note 9. P 11-13 by doing so, corporate governance also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance. See also Crowther D and Seifi S Corporate Governance and International Business (2011) 13-14.

³¹ Frederick D. Lipman and L Keith Lipman, Corporate Governance Best Practices: Strategies for Public, Private, and Not-for-Profit Organizations (2006) at 3 cited in Hussien Ahmed Tura, "Approaches to Reform Corporate Governance in Transition Economies: The Case of Ethiopia," p, 5. Available at SSRN: <http://ssrn.com/abstract=22933031> ≥ viewed on January, 11, 2020)

³² Ajith Nivard Cabraal, "Importance of Corporate Governance for the Banking and Financial Sector" (24-25 February, 2007) p,4. Accessed at <http://www.bis.org/review/r070314c.pdf?frames=0> ≥ viewed on January 3, 2020)

³³ Lutgart Van den Berghe and Liesbeth De Ridder, Cited above note 29, p.16.

³⁴ Cronin P et al Corporate Governance for Main Market and AIM Companies (Paper prepared by White Page Ltd in association with London Stock Exchange Plc 2012) 3 available at <http://www.londonstockexchange.com/companies-and-advisors/aim/publications/documents/corpgov.pdf> (accessed on 5 November 2014).

³⁵ Ibid.

³⁶OECD,³⁷ CACG,³⁸ UN, and ICGN,³⁹ among others. Nevertheless, the research will not dwell on each initiative's principles briefly except the OECD. The writer has opted to use the OECD Principles as the reasons stated under the previous chapter.

2.2.1 OECD Principles of Corporate Governance

The OECD Principles of corporate governance, which was first approved and issued by its member states in 1999 after the incidence of the 1997 series Asian financial catastrophe.⁴⁰ To address the anxieties of the newly developing markets and corporate governance failures, the principles have been reviewed in 2004. In general, the OECD principles incorporated six main core areas of good corporate governance. The first area of the principles advocates corporate governance framework which embraces legal, regulatory, and institutional supports should encourage transparent and efficient markets, be consistent with the rule of law, and allocate powers among supervisory and regulatory institutions.⁴¹ In doing so, the principles suggested that the newly premeditated corporate law and regulation should not only be cost-effective and enforceable rightfully with all market players but also avoid contradictory and overlapping provisions or regulatory gaps.⁴² The second area of the principles asserts the inherent ownership rights of shareholders should be recognized and protected by the corporate governance framework.⁴³ Shareholder's inherent rights consist of protected ownership registration, free transfer of shares, obtain all material and reliable information timely and regularly, participate, and vote at shareholders meetings and partake in dividends.⁴⁴ In a case where boards proposed to modify the company's statutes or subscriptions of new shares or extraordinary transactions of the company's assets, the principles recommend

³⁶ The World Bank was launched at the Bretton Woods Conference, New Hampshire held in July 1944 at the end of World War II. later also got involved in the promotion of good corporate governance. Visit http://www.worldbank.org/ifa/rosc_cg_egy.pdf for more information.

³⁷ The OECD has published the Principles of Corporate Governance (1999 and 2004) and the Guidelines on Corporate Governance of State-Owned Enterprises (2005).

Available at <http://www.oecd.org/corporate/ca/oecdcorporategovernanceworkingpapers.htm>.

³⁸ The CACG published the first set of corporate governance guidelines in 1999 to promote good standards in corporate governance and business practice throughout the Commonwealth (CAGG Guidelines (1999) 1).

³⁹ Over and above the UN Global Compact's 10 principles referred to in Chapter 1, para 1.5 above, the United Nations published "Guidance on Good Practices in Corporate Governance Disclosure" in 2006. The guidelines drew upon recommendations for disclosure relevant to corporate governance contained in such widely acknowledged documents as the OECD Principles of Corporate Governance, ICGN Principles, CACG Guidelines among others. The guidelines are accessible at http://unctad.org/en/docs/iteteb20063_en.pdf.

⁴⁰ Demise N. (2006) OECD Principles of Corporate Governance. In: Corporate Governance in Japan. Springer, Tokyo page 104. See also the OECD Principles of Corporate Governance (April 2004).

⁴¹ Cited above at note 9, Principles I

⁴² Ibid,

⁴³ Id, OECD Principles II.

⁴⁴ Id, OECD Principles II.A

shareholders should be fully informed and actively participate before passing such resolutions.⁴⁵ Hence, before the meetings, shareholders should be fully and timely updated on the voting procedures, dates, location, agenda, and the subject matter to be decided to nominate and elect boards, express their opinions on boards and key executive's remuneration and approve when the compensation is equity-based.⁴⁶ Additionally, the principles recommend that institutional investors' exercising of ownership rights should be encouraged. Nevertheless, while performing in a fiduciary capacity, they should reveal their corporate governance, voting policies and procedures, and how conflicts of interests are being managed.⁴⁷ Finally, the principles insist shareholders should be allowed to discuss with each other on matters concerning their essential ownership rights unless it is involved for an abusive purpose.⁴⁸

The third areas of the principles stipulate that the corporate governance framework should equal treatment of all shareholders' rights, including minority and foreign shareholders, and in case of violation, they should have the right to obtain effective remedies.⁴⁹ In addition, the requirements of prior approval if subsequent variations are made on voting rights involved in those classes of shares.⁵⁰ The fourth, areas of the principles desire that corporate governance frameworks should address the concerns of stakeholders provided by laws or contractual agreements. It should also enable strong relationships between companies and stakeholders in constructing wealth, jobs, and the long-term sustainability of companies' capital resources.⁵¹ The principles also prescribed that the long-term sustainability of companies hang on the outcomes of teamwork that integrates different resource providers inter alia investors, employees, creditors, and suppliers. They also state that the rights of these stakeholders provided by the law or contractual agreement should not only be valued but also in case of violations they should be fully rewarded.⁵² Additionally, they suggested employees' engagement in corporate governance should be permitted, however, their degree of engagement may be varied. It may be inboard members representation, representation by the worker's council to express their concerns on certain key governance decisions or partake in equity ownership plans or share profit depending on national laws and company's corporate

⁴⁵ Id, OECD Principles II, B

⁴⁶ Id, OECD Principles II, C, D, E

⁴⁷ Id, OECD Principle II, F.

⁴⁸ Id, OECD Principle II, G.

⁴⁹ Id, OECD Principle III.

⁵⁰ Ibid, OECD Principle III, A.

⁵¹ Id, OECD Principle IV, C.

⁵² Id, OECD Principle IV, A and B.

governance structures.⁵³ Once stakeholders are allowed to engage in the governance of the company, they should obtain full and material information timely and regularly for the accomplishment of their responsibilities.⁵⁴ Moreover, to avoid unethical conduct and illegal practices within the company, stakeholders and their representatives should be allowed to freely communicate such practices to the boards and their rights should not be affected as a result.⁵⁵ The fifth areas of the principles state corporate governance frameworks should pledge that the disclosure of information and transparency should be made timely and accurately on all relevant issues regarding internal governance of the company inter alia, financial performance and results, ownership structure, and corporate governance.⁵⁶ The principles further illustrate that the disclosed information should be not only prepared in “accordance with high quality financial and non-financial accounting standards” but also audited by independent, competent, and qualified external auditors.⁵⁷

The six and last areas of the principle urges for boards to strategically direct the company, effectively supervise the management and accountable to shareholders and the company.⁵⁸ In guiding the company and overseeing the management, boards’ structures and compositions may range from executive and non-executive boards to supervisory and management boards or additional statutory boards for auditing roles. Accordingly, the principles are premeditated to apply to all board structures and supports boards to perform “in a fully informed basis, in good faith, with due diligence and care,” and in the best interest of the company and shareholders.⁵⁹ This requirement imposes two fiduciary duties on the boards: the “duty of care and duty of loyalty.” The “duty of care” requires boards strategically guiding the company and overseeing the management. On the other hand, the “duty of loyalty” requires boards’ interests to pursue and their stewardship towards the shareholders and the company.⁶⁰ And for their collective and overall responsibilities, boards are required to access accurate, material, and timely information before making any decisions.⁶¹

⁵³Id, OECD Principle IV, C.

⁵⁴Ibid, OECD Principle IV, D.

⁵⁵Id, OECD Principle IV, E.

⁵⁶Id, OECD Principle V.

⁵⁷Ibid, OECD Principle V, B and C.

⁵⁸Ibid, OECD Principle VI, P.

⁵⁹ Id, OECD Principle VI, A

⁶⁰ Id, OECD Principle VI, B, C, D

⁶¹ Ibid, OECD Principle VI, F.

2.3 Modes of Corporate governance

Corporate governance systems differ across countries. Generally, in the corporate world, two prevailing board structures can be found a one-tier board or a Unitary model and two-tier board or dualistic model corporate board structure.⁶² In the Anglo-Saxon countries such as the UK, the US, and Canada the one-tier board structure is prevalently used, while in Continental European countries such as Germany, the Netherlands, and Finland the two-tier board structure is the norm.⁶³ Though board structure differs across nations, they have the same crucial objective, which is to monitor the administration of the company to protect the long-term interest of the shareholders and other stakeholders.⁶⁴

2.3.1 One-Tier (Unitary) Board Structure

Under this system, a single board performs the dual functions of executive management and supervisory. Thus, it is a unified system with no separate supervisory board.⁶⁵ Besides, the board also consists of executive and non-executive directors, who are appointed by shareholders and possess a great scope of functions concerned with managerial responsibilities.⁶⁶ Further, it holds that the pursuit of shareholders' interests is the only end of corporate governance and on this issue, Friedman says "there is one and only one social responsibility of business - to use its resources and participate in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without dishonesty or fraud..."⁶⁷

⁶² Though some countries such as Sweden, Japan have legal frameworks that cannot be classified as one-tier or two-tier systems its more of a hybrid system of board, which includes particulars of both systems, other countries, such as Belgium, Portugal and Spain, allow companies to choose between the two systems. The same once held true for France, but France has since introduced a third option through which more than one organ can be entrusted with executive supervision. See; Carsten Berrar, *Die Entwicklung der Corporate Governance in Deutschland im internationalen Vergleich* (Nomos Verlagsgesellschaft, Baden-Baden 2001) 36-41. See also; Michel Storck, 'Corporate Governance a la Francaise- Current Trends' (2004) 1 ECFR 36, 41-53.

⁶³ The two-tier board model has mainly German origins, thus wide spread in continental Europe. See K.J. Hopt, 'The German Two-Tier Board: Experience, Theories, Reforms', in K.J. Hopt, et al., eds., *Comparative Corporate Governance: The State of the Art and Emerging Research* (Oxford, 1998) pp. 227-228.

⁶⁴ Connelly, J. T., & Limpaphayom, P. (2004). Environmental reporting and firm performance: Evidence from Thailand. *The Journal of Corporate Citizenship*, (13), 137.

⁶⁵ Jonathan Rickford, 'Fundamentals, Developments and Trends in British Company Law - Some Wider Reflections - First Part: Overview and the British Approach' [2005] *European Company and Financial Law Review* 63, 73-78

⁶⁶ D.C. Clarke, 'Three Concepts of the Independent Director', 32 *Delaware Journal of Corporate Law* (2007) pp. 73-111. See also, Stefan Andreasson, *Shareholder and Stakeholder Interests: The Politics of Corporate Governance Reform in South Africa* (2006), p.4. last Accessed 20 November, 2019.

at http://bisa.ac.uk/index.php?option=com_bisa&task=download_paper&no_html=1&pass=>viewed_o

⁶⁷ Daniel K. Saint and Aseem Nath Tripathi, "the Shareholder and Stakeholder Theories of Corporate Purpose." P.2

But it is wise to consider that the interests of shareholders may not always be limited to wealth maximization.⁶⁸ It may go beyond wealth maximization which includes charitable conducts or notions of justice.⁶⁹

2.3.2 Two-Tier Board Structure

In this board structure, it distinguishes a management board and a supervisory board with no overlapping affiliation between them.⁷⁰ This model employs the dualism of a supervisory board and management board, and their mandates are kept independently which means that members of the supervisory board cannot be the members of the management board at the same time.⁷¹ In other words, the functions of control and monitoring are completely separated from executive functions in the two-tier model.⁷² The management board includes exclusively executives and officers who are responsible for the daily operation of the company. The management board is monitored and controlled by the supervisory board which includes non-executive directors only.⁷³ In short, the main role of the supervisory board is to assign, discharge, and monitor the members of the management board.⁷⁴ Moreover, they treat companies as social entities that are accountable to stakeholders beyond shareholders.⁷⁵

As a result, the two major corporate governance models are considered to be an endorser for good corporate board structures worldwide.

Reformers and practitioners, however, strongly emphasize that one-tier boards are not independent enough. Some authors even indicate that these boards are no more than ceremonial rubber-stamping devices to support the objectives of management.⁷⁶ Besides, Sheridan and Kendall point

. <http://www.knowledgeworkz.com/samatvam/newsletter/The%20Shareholder%20and%20> last accessed 28 November, 2019.

⁶⁸ Julian Velasco, "Shareholder Ownership and primacy," *University of Illinois Law Review*, No.3(2010), pp.945-946.

⁶⁹ Ibid.

⁷⁰ Jungmann, C. (2006). The effectiveness of corporate governance in one-tier and two-tier board Systems—Evidence from the UK and Germany—, *European Company and Financial Law Review*, 3 (4), 426-474.

⁷¹ Cited above at note 69. p228 This system can be found in countries like Germany, Netherlands, Austria, Finland, and Denmark, China, Indonesia, Russia, South Africa have adopted a two-tier system.

⁷² Ibid.

⁷³ Ibid.

⁷⁴ Ibid.

⁷⁵ Alberto Chilosì and Mirella Damiani, "Stakeholders vs Shareholders in Corporate Governance" (2007), P.2. Accessed at <http://mpa.ub.uni-muenchen.de/2334/>

⁷⁶ Rechner, P-L. and Dalton, D.R. (1991) CEO duality and organizational performance A longitudinal analysis, *strategic management journal*, 12; P,155-160.

out that, “the uncomfortable untidiness in having one group of a director’s supervising or controlling another group on the same board, which is meant to be the aggregation for managing the company.”⁷⁷ Additional criticism of the one-tier model is the joint practice of uniting the positions of chairman and CEO.⁷⁸ Scholars though refer to the Continental-European two-tier board as a structure that noticeably separates executive director’s from non-executive directors.⁷⁹ The board responsibilities of executives and non-executives directors are well defined by two separate boards.⁸⁰ Additionally, the supervisory board is composed entirely of non-executive directors, which secures an independent composition of the board.⁸¹ These clarifications suggest that reformers implicitly address key aspects of the two-tier board to increase board independence in the one-tier board.

The Commercial Code of Ethiopia contains several important provisions that bear on corporate governance.⁸² In the same manner, relevant provisions of the Commercial Code that dealt with the legal requirements of establishing a share company stipulated under Arts. 304 to 509. By looking deep in those provisions, we can understand that the Ethiopian share company corporate board structure trails to follow the unitary model (one-tier board) structure, such kind of board structure puts both the managerial and supervisory responsibilities in one unified board of directors arrangements.⁸³ As a result, this kind of structure will give the board of directors the ultimate managing body of decisions making and at the same time, monitor these decisions. And this kind of double function would lead to dominating the board, constraining the board's monitoring function and also restricting the representation of shareholder's interest.

So, what we can understand from the above statement is that the role of a board of directors is vital especially in Share Companies by way of dispersed ownership because shareholders are unable to closely monitor, supervise and manage their company due to lack of information and resources. Thus, the Commercial Code does not have sufficient provisions that dealt with the corporate

⁷⁷Sharidan, T. and Kendall, N. (1992) corporate governance, An action plan for profitability and Business Success, Financial Times/Pitman Publishing, London.

⁷⁸ Boyed, B.k.(1995) CEO Duality and Firm Performance: A contingency Model, Strategic Management Journal, 16 301-312.

⁷⁹ Ibid.

⁸⁰ Ibid.

⁸¹ Pic, J. (1995) Europe’s Diverse Corporate Boards How They Differ From Each Other & the U.S. In: point of view, spencer Stuart.

⁸² Commercial Code of the Empire of Ethiopia, 1960, Extra Ordinary Issue, Nagaret Gazeta, Year. 19th, No. 3, (herein after called Commercial Code)

⁸³ Id. 347(1)

governance of the company's and protecting the rights of shareholders.⁸⁴ As Minga Negash, perceives that the status of corporate governance in Ethiopia is poor and notes that "the Commercial Code of 1960 does not provide an adequate legislative response to complex governance issues and recommended for the enactment progressive corporate governance codes and standards in Ethiopia."⁸⁵

Furthermore, the Commercial Code stipulates that directors can be appointed either by the memorandum of association or by the general meeting of shareholders.⁸⁶It also lay down that the chosen director can elect chairman among themselves, which the law not only failed to safeguard the chairman being an independent director, nonetheless, it doesn't even require the inclusion of an independent board director body.⁸⁷ Hence, there is no doubt that the independence of directors is critical for Share Companies to stay in business if they are not managed in the interests of these key groups.

⁸⁴Hussien Ahmed Tura," Overview of Corporate Governance in Ethiopia: The Role, Composition and Remuneration of Board of Directors in Share Companies," Mizan Law Review, Vol.6, No.1(2012), p.49-50

⁸⁵ Minga Negash (2008), Rethinking Corporate Governance in Ethiopia, (University of the Witwatersrand), Ethiopian E-Journal for Research and Innovation, (Volume 5, No 1 (2013)), p.2

⁸⁶ Com. C, Art 350.

⁸⁷ Com. C, Art 363.

Chapter-Three

3. Corporate Governance and the Structure of Board of Directors in Ethiopian Share Companies

3.1 Existing Governance Regulation and Supervision of Share Companies in Ethiopia

In the corporate world, the way they govern and controlled has an adverse impact on the country's economy. History further provided that holding a weak regulatory and supervisory framework in a certain nation could create a potential trait for having a disintegrating economy. In the Ethiopian context, the primary legislation that applies to all share companies in Ethiopia is the commercial code which holds the basic rules on the governance of companies.⁸⁸ However, the law only provides regulatory and supervisory power left to the ministry of Trade in the formation, ongoing functions, and governance of companies.⁸⁹ Considering the aforementioned the office has the power for registering newly formed companies and depositing companies statues and other periodical reports;⁹⁰ regulating cross-holding of shares among holding companies,⁹¹ reducing directors' remuneration upon the application of shareholders not less 10% of the share capitals of the company⁹² and by its initiation or upon the application of shareholders, order to conduct an investigation of companies scandals and nominee shareholders.⁹³

On the other hand, regulation, and supervision in the financial sector designated to the NBE, in addition to the general rules embodied under the commercial Code.⁹⁴ However, we cannot dwell on these without making unwarranted digression from the theme of the study. As a result, the study will only focus on the governance of the share company under the commercial code.

⁸⁸ It should be understood that all companies are required to adhere to the provisions of the Commercial Code, save some clear amendments or repeals, whether financial or non- financial Share Companies. In addition to the Commercial law financial Share Companies are required to comply with other laws including, proclamations, regulations and directives issued to regulate them.

⁸⁹ Com. C, Arts.99.

⁹⁰ Com. C, Art 323, and 447.

⁹¹ Com. C, Art 344.

⁹² Com. C, Art 353(7).

⁹³ Com. C, Art 318-387.

⁹⁴ Banking proclamation, Art.5 (7).

3.2 Role and Responsibility of Board of Directors in the Corporate Governance of Share Company

Corporations have increased in size and complication and they require more multipart organizational structures and a more varied workforce possessing several levels and areas of expertise.⁹⁵ As a result, the existence of the board of directors is becoming a crucial axis in the governance structure by performing various roles and activities and to function as a highly professional body of a company.⁹⁶ In a certain corporation, directors have three different main roles by having in mind their relevance from the normative point of view and corporate governance practice. These roles are i) the decision-making role; ii) the supervisory role, and iii) the relational role.

The first role is based on the idea that the board of directors is the cornerstone of all legal power and authority in the corporation.⁹⁷ Although shareholders in the general meeting have the ultimate control of the company,⁹⁸ they do not intervene in the management of the company, and their functions and rights are exercised only occasionally.⁹⁹ Then, the idea is that the shareholders have given to the board the main responsibilities relating to the strategy and functioning of the company. This level of authority makes the corporation boards the most vital decision-making body within the company.¹⁰⁰ Normally, companies with scatter shareholding directors are not very active when performing these activities; instead, it is expected that they behave in a more passive manner. Restrictions of time and lack of information would not allow directors to formulate much of the strategic decisions and policies.¹⁰¹ In fact, boards in reality just approve the policies and strategies that company executives bring before them.¹⁰²

The second role deliberates that the board as a group-decision making body in which all the members (directors) have the same responsibilities and purposes. Besides, decisions are made by

⁹⁵ Lynne L. Dallas, *the Multiple Roles of Corporate Boards of Directors*, 40 *San Diego Law Review*, 781, 781 (2003).

⁹⁶ Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 *Hofstra Law Review*, 89-173, 92 (2004). Available at: http://www.hofstra.edu/PDF/law_law-rev_gevurtz_vol33no1.pdf.

⁹⁷ Charles R. T. O'Kelley & Robert B. Thompson, *Corporations and Other Business Associations: Cases and Materials*, 136 (4th ed., Aspen Publishers, New York, 2003).

⁹⁸ Andrew Hicks & S. H. Goo, *Cases and Materials of Company Law*, 190 (5th ed., Oxford University Press, 2004).

⁹⁹ *Ibid.*

¹⁰⁰ Paul L. Davies, *Gower and Davies: The Principles of Modern Company Law*, 365 (8th ed., Sweet & Maxwell, London, 2008).

¹⁰¹ Cited above at note 101.

¹⁰² *Ibid.*

the group under certain requirements and formalities so individuals by themselves do not have the power to act but as a group. As a result, it is also possible to find that the main objective is to avoid conduct like self-dealing, negligence, and lack of professionalism on the part of the management of the company.¹⁰³ In this manner, boards oversee the activities of officers and they are responsible for providing the right incentives in the best interest of the company.¹⁰⁴

The third role contemplates in recent years the business community has absorbed in having more diverse boards.¹⁰⁵ The idea is that the board is an instrument which provides a set of inter-linking system¹⁰⁶ and advice for the benefit of the company.¹⁰⁷ Under this approach, the company reduces reservations about the resources (credit, workforce, clients) needed to operate and increases the chances of existence through board membership.¹⁰⁸ Board membership is used as a bridging strategy to link the company with the stakeholders of the company and its social environment.¹⁰⁹

When we come to the roles of board of directors under the commercial code of Ethiopia as it is clearly provided under article 350 (1) of the commercial code, the first directors may be appointed under the memorandum or articles of association. However, this appointment has to be confirmed by the meeting of subscribers, which will be conducted in accordance with article 320 of the commercial code. Other directors who will be appointed after the formation of the company will be appointed by the shareholder's general meeting in accordance with article 350(2) of the commercial code. In addition, the duties and responsibilities of directors provided under articles from 362-364 of the code. Since director's act as an agent of the company they are required to carry out their responsibilities with the due care as it's clearly provided under article 364(1) of the code. This due care obligation shall be interpreted in light of the civil code provisions. Accordingly, Article 2211 of the civil code requires the agent to exercise its obligation in the same diligence as a *bonus pater familias*. The same obligation shall be applicable to the duties of

¹⁰³Cited above at note 98.

¹⁰⁴Ibid.

¹⁰⁵Ibid.

¹⁰⁶ "Networking with stakeholders and business partners and the balancing of interest within the corporation have been rated as indispensably valuable, particularly for resolving desperate situations". Klaus J. Hopt & Patrick C. Leyens, Board Models in Europe - Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France and Italy, 1 European Company and Financial Law Review, ECFR, 2, 135-168, 141 (2004). Available at: <http://www.refierence-global.com/doi/abs/10.1515/ecfr.2004.1.2.135>.

¹⁰⁷Cited above at note 77, P 227-258, 233-235

¹⁰⁸Lynne L. Dallas, Proposal for Reform of Corporate Boards of Directors: The Dual Board and Board Ombudspersons, 54 Washington & Lee Law Review, 91, 101 (1997).

¹⁰⁹ Ibid.

directors since as a remunerated agent of the company high standard of diligence is required from the board of directors. To this effect, prohibitions related to the agency-principal relationships are provided in the commercial code. Consequently, article 355 of the code prohibits the board of directors from undertaking private trades. The provision, particularly, prohibits directors from being partners with joint and several liabilities in rival companies or competing against the company either on their own behalf or on behalf of third parties without getting an authorization from the general meeting. This is a clear extension of the concept of directors as agents of the company.

Furthermore, article 356 of the code prohibits dealings between the company and its directors without getting the required authorization from the general meeting of shareholders. A similar provision can also be notice under the civil code. According to article 2188 of the civil code, the agent is prohibited from making a contract with himself if the deal raises conflict of interest situation with that of the company. Therefore, the directors have a similar obligation of avoiding conflict of case scenarios' during the performance of their agency obligation. In addition to this, the directors are prohibited from taking a loan from the company. This is clearly provided under article 357 of the commercial code.

These all provisions have shown that board of directors is the organ of a company appointed by the shareholders to represent them and to carry out very important obligations in the interest of the company. In addition to this, as the agent of the company, the provisions stipulate restriction in the acts of the board of directors and standards required from the board in carrying out the obligations assigned to it by law, articles, and memorandum of association. Within this general power, other commercial code provisions have empowered the board of directors to undertake basic responsibilities in the management of the company. In the next section of this paper, attempts have made to analyze some of these important responsibilities of the board of directors in the commercial code of Ethiopia.

3.2.1 Calling Shareholders' Meeting and Setting its Agenda

In the Ethiopian commercial code, shareholder's meeting is the ultimate decision-making organ of the company. As provided under article 388 of the code, a general meeting of shareholders, properly established and conducted its business in accordance with the law, acts on behalf of all shareholders, and its decision shall bind all shareholders whether absent, dissenting, incapable or

having no right to vote. Thus, the shareholder's meeting has a vital power in the undertakings of the company. In relation to this, the board of directors has two related responsibilities. The first one is that the board of directors has the duty to call for the shareholder's meeting. Secondly, the board has the responsibility to set the agenda for the meeting. The first responsibility is provided under article 391 (1) of the code. According to this provision, general meetings are called by the directors, the auditors, the liquidators, or where appropriate, by an officer of the court. Therefore, the board of directors is mandated to call the shareholder's meeting. This mandate of the board of directors may sometimes be compulsory. This can be seen from article 362 (e) of the code. In accordance with this provision, board of directors shall convene a general meeting without delay where three-quarters of the capital is lost. Furthermore, the board of directors may also be required to convene a general meeting by the articles of association as per article 362(d) of the code. Therefore, the board of directors has the mandate and the responsibility to convene general meetings in accordance with the commercial code provisions.

The second responsibility of the board of directors concerning shareholders meeting is setting meetings' agenda. This responsibility is also provided in the commercial code. In accordance with Article 397 (1) of the code, the general meetings' agenda shall be prepared by the person calling the meeting. As we have seen it above, the board of directors have the mandate to call shareholders meeting. As a corollary mandate, article 397 of the code dictates the board of directors to set agendas for the general meetings. In relation to this, the board of directors are required to keep records of such meetings. Thus, they have required to record the agenda of the meeting and the decisions rendered thereof. This can be seen from article 362 (a) and 411 of the code. Generally, the board of directors have an extended power in the shareholders meeting and it can be said that it is the mastermind behind in most of the shareholder's decision.¹¹⁰ In any hierarchical arrangements, a certain body is responsible and accountable to the organ that has elected it. This logic is also applicable in the case of board of directors. As we have seen it earlier, board of directors is appointed by the subscriber or the shareholders general meeting. This means that shareholders are the one who are empowered to elect the members of the board of directors. Based

¹¹⁰ The writer has interviewed W/ro Feven Mulat, a corporate lawyer at BGI Ethiopia and its affiliates, regarding the power of the board of directors in the shareholders general meeting. She stated that in most of the cases the board of directors has an extended power in arranging such meetings and controlling the overall flow of the meeting. She further stated that the board of directors has also the potential to influence the decision of the shareholders general meetings' decision in addition to what the law mandates to them. Therefore, these provisions of the commercial code are practically relevant.

on this arrangement, the commercial code contained several provisions in relation to the accountability of the board of directors to the shareholders meeting. To begin with, the board of directors is responsible to submit annual reports to the general meeting in accordance with article 362(c) of the code. Based on this report, the acts and undertakings of the board will be evaluated in light of its obligations as well as standards provided under article 364 of the code. Moreover, the auditors of the company will review those reports in accordance with article 374 (c) and 376 of the code. Therefore, the accountability of the board towards the shareholders meeting will be channeled through this reporting system. However, we should not forget that the accountability of the board to the shareholders meeting is not without sanction. In order to make sure that the board has dictated to carry out its assignments in accordance with the law important provisions are provided in the commercial code. Based on this, article 364 of the commercial code is relevant. In accordance with this provision, directors shall be responsible for exercising the duties imposed on them by law, the memorandum or articles of association and resolutions of meetings, with the care due from an agent. Thus, the board of directors as an agent of the company they are required to perform all the obligations provided in the preceding subsections of this term paper. Failure to perform these assignments and obligation in accordance with the law would lead to individual and collective liability in accordance with article 364 (3) and (4) of the code.

Generally, we can see that board of directors in the commercial code of Ethiopia is the organ mandated by the law and articles and memorandum of association to exercises the powers that have been assigned to it. For this purpose, the organ is collectively accountable for performance of its assignments to the meeting of shareholders. Therefore, in accordance with the study and other writers' assessment the commercial code, except on some matters that have been outlined, has contained adequate provisions regarding the mandate and responsibility of the board of directors.

3.2.2 Appointing and Dismissing the Chairman, the Chief Executive Officer and Deputy Chief Executive Officers

As we have seen it above, in the hierarchy of the organs of the company board of directors is the highest organ next to the shareholders meeting. Due to this, we can say that the board of directors is the highest management body in the company. This can be seen from article 347(1) of the code. This ultimate management authority of the board of directors gives it the mandate to appoint and dismiss the chairman, the chief executive officer and the deputy chief executive officer.

Accordingly, article 348 of the commercial code is relevant to this mandate of the board of directors. In accordance with this provision, board of directors has the power to elect or revoke the chairman of the board and the general manager. To begin with the appointment of the chairman of the board, article 348(1) of the code stated that the board shall elect a chairman from among its members where no chairman has been elected by a meeting of subscribers or shareholders. This is to mean that the original right of appointing the chairman of the board of directors is reserved to the subscriber or shareholders. However, in any case, when the subscribers failed to appoint the chairman of the board, the board is mandated to appoint the chairman by itself. The only condition provided in this provision is that the board of directors is required to appoint the chairman from among its members. Thus, we can say that the board of directors has a derivative right of appointing its chairman. Within this mandate, the board has also the power to dismiss the chairman it appointed. In accordance with Article 348(2) of the code, the board may revoke the appointment of a chairman elected by the board. Therefore, we can say that the commercial code has authorized the board of directors to appoint and revoke its chairman.

With respect to the appointment and dismissal of the chief executive officer and the deputy chief executive officers,¹¹¹the commercial code does not adequately regulate the matter. Article 348(2) of the commercial code stated that the general manager shall be appointed by the board. In relation to this, article 348(4) of the code states that the general manager is an employee of the company and may not be a director. These two provisions imply that the general manager is an employee of the company and it is solely appointed by the board. Furthermore, article 348(2) provides that the provisions of Art. 34, 35, 109 (1) (f) and 121 (h) of this Code shall apply in the appointment procedure. Accordingly, article 34 of the code stated that the manager shall be deemed to have full power to carry out all acts of management connected with the exercise of the trade, including the power to sign a negotiable instrument. And article 121(h) requires registration in cases of dismissal of the manager. Apart from this, the law does not give other regulatory framework for the appointment and dismissal of the general manager.

In relation to the dismissal of the general manager, the code is silent. Therefore, as an employee of the company the manager's fate will be determined by the contract of employment, he/she has

¹¹¹ The term chief executive officer and the deputy chief executive officers have not been used in the commercial code of Ethiopia. Thus, the writer has employed the term general manager and deputy general manager interchangeably with the term chief executive officer and the deputy chief executive officers respectively.

with the company. Logically speaking, the board may dismiss the manager in accordance with the terms and conditions of the employment contract. In addition to this, in most of the cases the board of directors are mandated to appoint and dismiss the general manager and the deputy manager based on the mandate it acquired from the articles and memorandum of association. With respect to the deputy manager or the deputy chief executive officer the commercial code is silent. However, as we have said earlier, article 362(1) stated that the directors shall have such powers as are given to them by law, the memorandum or articles of association and resolutions passed at meetings of shareholders. Thus, in most of practical cases, the boards are mandated by the memorandum and articles of association to appoint and dismiss the deputy chief executive officer.¹¹² Therefore, although the commercial code does not have adequate provision regarding the appointment and dismissal of the chairman, the chief executive officer and the deputy chief executive officers of a company, we can generally say that the board is mandated by the code to appoint and dismiss the chairman and the chief executive officer and has to be mandated by the memorandum and articles of association to appoint and dismiss the deputy chief executive officer.

3.2.3 Supervision of the Management

As foregoing the writer has repeatedly cited article 347(1) of the code, which mandates the board of directors with the ultimate body in the management of the company. This provision has mandated the board to be a vital body in the management of the company. However, the problem with the commercial code in relation to this is that the code does not provide a clear distinction between the governance and supervisory role of the board of directors. Some writers argue that *...there is no requirement of the law that clearly distinguishes the management responsibilities of directors from that of directing and supervising the management of a company.*¹¹³ This is true due to the absence of clear provisions indicating the supervisory power of the board of directors in the commercial code. However, when we refer article 347(1) and 348(3) of the code, which mandates the board to manage the company and appoint the general manager respectively, we can see that the board has the power to supervise the acts of the management. This is due to the fact that as an

¹¹² The writer had interviewed Ato Tilahun Mitiku, a former judge at the federal high court currently enrolling as an Attorney and Corporate Law consultant, regarding this power of the board. According to him, in almost all cases boards are mandated to appoint and dismiss the chief executive officer and deputy chief executive officer by the company's memorandum and articles of association. Therefore, even if the commercial code seems hesitant in regulating this issue the memorandum and articles of association can fill this gap by giving additional mandate to the directors.

¹¹³ Cited above at note 93.p.61

appointing organ of the management team the board has the mandate to supervise their act thereof. In addition to this, as provided under article 33 and 35 of the commercial code, upon their appointment managers are mandated to carry out acts of management and to sign in the name of the trader. Practically, the boards of directors appoint the general manager who is responsible for the day-to-day activities of the company in the memorandum and articles of association. This manager is directly responsible for the board of directors and the board has the mandate to supervise the acts performed by the manager and its team.

In accordance with Husen Ahmed Tura: -

The Articles of Association of financial institutions such as Awash International Bank and Awash Insurance Company, Bunna International Bank, Wogagen Bank as well as non-financial share companies such as Cheha Business SC, Ehil Beranda Ehil Negadewoch SC, Papirus School SC, Sky Bus SC, Crstal Tannery SC, Yeshera Tera Birhan Limat SC etc, which indicate that the role of the board is to direct and supervise the company and the management while day to day activities are run by the general manager.¹¹⁴

Therefore, in most of the cases the board has the power of supervising the management of the company in accordance with the articles and memorandum of association, despite the deficiency of the commercial code to entertain the matter expressly.

3.2.4. Determination of the Annual Accounts and Reports its Action in the Annual Report

These two important obligations of the board of directors are provided under article 362(c) of the commercial code. In accordance with this provision, board of directors is responsible for submitting the accounts to the auditors and an annual report of the company's operations including a financial statement to the shareholders meetings. For this purpose, article 362(b) of the code requires the board to keep books and accounts of the company. From this we can see that the board of directors is empowered to determine the annual accounts of the company submitted to the shareholders meeting for approval in accordance with article 419 of the commercial code. However, this mandate of the board is under the strict supervision of the auditors of the company. In accordance with article 374 (c) and 376 of the code, the reports of the board are controlled and supervised by the auditors. In any way, the board of directors has the power to determine the annual

¹¹⁴ Ibid

accounts of the company as provided in the commercial code. Related to this, the board of directors has also the responsibility to report its action to the shareholders meeting in the annual reporting.

3.3 Challenges of the Existing One-Tire Board Structure Under the Commercial Code

The study has gathered important information regarding the board of directors, their roles, and their structure. In this manner, it is possible to have a fair picture of this body including the origin and possible reasons for its existence, relation to the company and obligation of the board members, as well as its effectiveness. It is also possible to say that the board of directors in different companies have different complex issues, its functioning and the delivery of its activities have been one of the objects of infinite discussions in corporate governance land. However, the interest of the final part of this research is to comprehend why this body seems to be at the center of the storm in times of disasters because it has not been able to perform its functions properly.

With this purpose in mind, this study will try to give some reasons that could help to understand the board's underperformance. In the following, the paper will refer to four different features that may be critical taking into consideration Ethiopian Share Company's experience and some of the issues mentioned in previous chapters.

3.3.1 Conflicting Role

As aforesaid the board of directors has two main roles which have been called the strategic decision-making role and monitoring role. In this manner, the board primarily formulates goals and strategies for the company, in other words, the board defines the path of the company what should follow and also whom to appoint the squad responsible for this duty. Besides, the board must evaluate performance, compliance and make a risk assessment of the company, meaning that the board should evaluate what and how the company is doing to achieve the goals that have been fixed. In principle, the two roles have a different scope and they could be divided from an intellectual perspective. However, when the board is functioning, in practice, the two roles are interconnected. Interestingly, while in theory, it would be possible to say that the two roles are complementary, once they are applied, they end up being conflicting. Therefore, there is a natural

inconsistency between the board's monitoring and managing functions.¹¹⁵ If the board participates in the corporate decision-making it could sacrifice the capacity to monitor those decisions independently.¹¹⁶ But, if the board maintains a significant distance there is a risk of not understanding the company which is supposed to monitor.¹¹⁷ For instance, once the board gets involved in a decision, either by acting or no acting, it could be more difficult for the board to judge objectively future actions concerning that decision.

3.3.2 Independence of Board the of Directors

The corporate governance movement has relieved most -if not all- of the responsibility of good governance at the board level in independent directors and committees. For instance; In the US case, the two most important regulatory requirements stated for public-listed corporations are related to these two icons. In addition, In the UK case, it is compulsory to have independent board members yet, it is common practice to have them in listed companies.¹¹⁸ Though, in the Ethiopian share company, there are no such conditions with regard to the inclusion of independent directors. Moreover, the only prerequisite that needed to be fulfilled is being a shareholder of the corporation there is not additional competitive qualification requirements.¹¹⁹ Fascinatingly, if we see further under article 348(4) of the English version of the Commercial Code states that “the general manager may not be a director.” However, this article is inconsistent with the corresponding Amharic version of the Code which says “ዋና ስራ አስኪያጁ የኩባንያው ስራተኛ ነው አስተዳዳሪም ላይሆን ይቻላል.” But the Amharic version is the authoritative one, and Article 348(4) is not mandatory and managers may be appointed as director of companies instantaneously which makes it worst to safeguard at least the independence of the board room from other influential CEOs and other block shareholders.

¹¹⁵ Germany's flawed corporate governance - Boards behaving badly, why the leading citizens of corporate Germany are so scandal-prone, The Economist, Berlin, August 6th, 2009. Available at: <http://www.economist.com/node/14183029>.

¹¹⁶ Florence Shu-Acuquaye, The Independent Board of Directors and Governance in the United States: Where is this Heading? 27 Whittier Law Review, 725-753, 733 (2006).

¹¹⁷ Ibid.

¹¹⁸ For instance, the 34th Board of Directors Study concluded that in 2007 the average board consisted of 10 directors, two of them full-time employees of the company (insiders) and eight of them from outside the organization. See the Korn/Ferry Institute, 34th Annual Board of Directors Study, 6 (2008). Available in: http://www.kornferryinstitute.com/files/pdf1/Board_Study07_LoRez_FINAL.pdf.

¹¹⁹ Com, C. Art 347(1)

Further, the OECD Principles as stated under chapter two of this study, one of the preconditions needed to be provided to have a good corporate governance is upholding an independent director in the boardroom.¹²⁰ But then again, they are not enough to restrain the problems in the boardroom. The problem is that modern corporate law has treated independence as ends in themselves¹²¹ and companies have forgotten that they are only (very important) means to govern the company. As a result, this misconception has created the board independence and they have been understood as the answer to the problems in the board. Following this, some Share Companies insert clauses that their CEO may be member of the Board of directors to be named as managing directors like Selam Bus Lines Share Company.¹²²

3.3.3 Board at the Intersection

The board of directors is at the intersection (decisive role and important) comparing to all the different actors in the company. As aforementioned, directors are appointed by the meeting of the shareholders,¹²³ and the only prerequisite that needs to be fulfilled is being a shareholder, there is no further qualification requirement. Unlike financial companies which subject directors, CEOs and senior executive officers to meet the competency requirements and approval of the national bank.¹²⁴ The absence of an equivalent requirement for the directors of non-financial share companies not only results in a concentration of power in the hands of few people who are obliged to make and monitor the same decision simultaneously. It will also result in the deployment of unskilled or incompetent shareholders plus investors and shareholders to assume the executive post in corporations. Which makes it too bad and pushes us to argue apparently that it would better to appoint external professional, senior employees, and experts having technical, financial, and legal knowledge or specialization in the sector.¹²⁵ Holding a balance of advisors and professionals who have broad perspectives and insight is the key to having a well-performing board room. The writer has observed some selected files of non-financial Share Companies in the Ministry of Trade archives with regard to their composition and structure of board of directors with in the company

¹²⁰ Cited above at note 54, OECD principle VI.E, p63-64

¹²¹ Usha Rodrigues, *The Fetishization of Independence*, 7 University of Georgia Legal Studies Research Paper, 3-4 (2007); 33 *Journal of Corporation Law*, 447- 496 (2008). http://papers.ssrn.com/sol3/papers.cfm?abstract_id=968513

¹²² For instance, see Article of Association of Selam Bus Lines Share Company, Art.18 (1), available at FDRE Ministry of trade achieves accessed on March 18, 2020.

¹²³ Commercial code, Art 321(4)

¹²⁴ See Art 5 (1) (f) of Micro-Finance Business Proclamation No. 626/2009, Art 4(1) (g) of a proclamation to provide for insurance Business: Proclamation No. 746/2012 and Art 4 (1) (g) of banking Business Proclamation No. 592/2008.

¹²⁵ Cited above at note 81, p.65

in connection to their memorandum and article of association. As a result the writer come across to observe that most of the companies are demand that only shareholders can be directors as the law prescribes but none of them have a clause on the competence and professional qualification to serve as board of directors owing to the silence of the Commercial Code even worst some companies don't even provide as to who can be a director to run the company.¹²⁶ Similarly, there is no clue with regard to the requirement of formation of committees or the appointment of independent professional directors and experts in the area where the company is intended to engage in.

¹²⁶ See for more details Bewket Abebe, (Fortune Staff Writer), Hibir Sugar SC, which narrowly escaped liquidation a month ago, signed a memorandum of understanding (MoU) with the Ethiopian Metal & Engineering Corporation (MetEC), Addis Fortune Vol.14, No.701, (October 06, 2013) last assessed march 21, 2020.

Chapter-Four

4. The Desirability of Introducing a Two-Tier Board Structure in the Ethiopian Corporate Governance System

4.1. Structure of Two-Tier Board Model

Basically, under, this model gives stakeholders a "voice" in the way the company is managed and management seeks to accommodate their interest in deciding about corporate action.¹²⁷ As a result a pure two-tier model is required to have two boards: the management board and the supervisory board.¹²⁸ The two boards are organized in a vertical relation being the supervisory board responsible for the appointment of the management board.¹²⁹

4.1.1 The Management Board

The management board is responsible for the day-to-day management of the company.¹³⁰ In principle, the management issues are part of the autonomous decision process of this board without shareholders or supervisory board intervention.¹³¹ In fact, the management board cannot be removed by the supervisory board without cause and some decisions are an exclusive part of its competence.¹³²

The management board may consist of one or more persons if they are two or more they have to act jointly unless it is provided otherwise.¹³³ The members have equal rights and a Chief Executive Officer (CEO) does not exist like in the Anglo-Saxon model.¹³⁴ Nevertheless, in practice in some jurisdictions, the board has a spokesman or chairman who has a casting vote but cannot give instructions to the other members.¹³⁵ Besides, the existence of rules of internal procedure for the

¹²⁷ Jeswald W. Salacuse, Corporate Governance in the New Century, 25 Company Lawyer 3, 69-83, 75 (2004).

¹²⁸ Carsten Jungmann, The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems, 3 European Company and Financial Law Review, ECFR, 4, 426-474, 432 (2006). Available at: <http://related.springerprotocols.com/lp/de-gruyter/the-effectiveness-of-corporate-governance-in-one-tier-and-two-tier-hfxIKqJI7g>. last accessed 28, March 2020.

¹²⁹ Reinier R. Kraakman, Paul Davies, Henry Hansmann, Gerard Hertig, Klaus Hopt, Hideki Kanda & Edward Rock, eds., The Anatomy of Corporate Law: A Comparative and Functional Approach, 35 (Oxford University Press, New York, 2004).

¹³⁰ Cited above note 29.

¹³¹ Cited above at note 136.

¹³² Cited above at note 137.

¹³³ Alice Belcher & Till Naruisch, The Evolution of Business Knowledge in the Context of Unitary and Two-Tier Board Structures, 4 Journal of Business Law, 443-472, 451 (July 2005).

¹³⁴ Id, p452.

¹³⁵ Id, p453.

management board revealing, among other things, to the internal decision-making process and distribution of powers and duties among the board members, is very common.¹³⁶ Additionally, the members of the management board cannot be members of the supervisory board.¹³⁷ Neither, the management board could delegate any of the executive occupations to the supervisory board.¹³⁸

4.1.2 Supervisory Board

The supervisory board suggests, controls, advice, and discharges the management board.¹³⁹ Similarly, the board participates in some basic corporate decisions, for example, the annual report and other transactions that may be subject to its approval consulting to bylaws of the company or by the decision of the board itself.¹⁴⁰ In short, the supervisory board functions are primarily linked to monitoring and advising the management board. In this context, the supervisory board controls the management board (not the company) in matters related to compliance with the law and the company's article of association and the corporate strategies as well.¹⁴¹ All members of the board have the same rights and responsibilities¹⁴² and only a natural person with complete legal capacity is eligible to be a member of the supervisory board.¹⁴³ The board members have no right to represent the company, except when, acting on behalf of the company, they emphasize claims against former and present members of the management board.¹⁴⁴

In normal circumstances, the supervisory board is elected by the shareholders but in large companies employees could select up to half of the seats on the board.¹⁴⁵ In some jurisdictions, the

¹³⁶ Id, p458.

¹³⁷ Cited above at note 110.p 141 "Membership in the supervisory board is incompatible to simultaneous membership in the management board.

¹³⁸ Thomas J. André, Jr., Some Reflections on German Corporate Governance: A Glimpse at German Supervisory Boards, 70 Tulane Law Review, 1819, 1824 (1995-1996).

¹³⁹ Cited above at note 63.p 226.

¹⁴⁰ Cited above at note 140.p432 "In addition, the supervisory board must approve the annual accounts and can intervene in cases where the company's interest is seriously affected. For certain extensive and fundamental decisions, the by-laws must impose that authorization by the supervisory board is required".

¹⁴¹ Klaus J. Hopt & Patrick C. Leyens, Board Models in Europe - Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France and Italy, 1 European Company and Financial Law Review, ECFR, 2, 135-168, 141 (2004). Available at:

<http://www.refereceglobal.com/doi/abs/10.1515/ecfr.2004.1.2.135>.

¹⁴² Cited above at note 142. p457

¹⁴³ Id. P456

¹⁴⁴ Ibid

¹⁴⁵ Cited above at note 147.p432 "This composition of the supervisory board is due to the German laws of co-determination in companies with more than 500 employees: depending on the size and the business of the corporation, up to 50% if the members of the supervisory board are labour representatives. They are elected in a rather complicated procedure governed by the applicable co-determination act, while the representatives of the shareholders are elected

presence of employees in the supervisory board is considered as vital tool for keeping a balance between the interests of shareholders and other important stakeholders.¹⁴⁶ However, it is worth to stipulate that the chairman casting vote stretches the shareholders the final word in case of difference among board members.¹⁴⁷ The chairman fulfills administrative tasks (co-ordinates the work in the supervisory board) and s/he is used as a pipeline between the management and supervisory boards. Nevertheless, from the legal perspective s/he does not have a right to give instructions to his colleagues in neither of the boards.¹⁴⁸ Another important characteristic of the monitoring board is that it provides an important space for networking and the participation of stakeholders in the company. Paul L. Davies has observed on this issue in the following terms:

*Appointments to the supervisory board were a process of establishing and maintaining links between the corporation and other financial and non-financial institutions whose co-operation was important for the company's success. This might be view as an early form of stake-holding, where the stakeholders are defined as those who have a long-term interest in the economic achievement of the company.*¹⁴⁹

Additionally, the rest committees (audit, nomination, and remuneration) are now playing a more important role in the supervisory board structure, without harming the collective responsibility of the supervisory board as a whole.¹⁵⁰ Also, it is common to have committees between the chairmen of the two boards.¹⁵¹

4.2. Evaluation of the Two-Tier Board Structure (pros' and cons')

One of the key advantages of having a dual board structure is the strict separation of the controlling and management board.¹⁵² Such structure would remedy the problem of the executive director by

in the general meeting by the shareholders". Carsten Jungmann, *The Effectiveness of Corporate Governance in One - Tier and Two -Tier Board Systems*, 3.

¹⁴⁶Cited above at note 110. "employees' participation is at the heart of industrial democracy, and it is not surprising that German co-determination finds its roots mainly in the difficult times after World Wars I and II".

¹⁴⁷ Cited above at note 142.p 1826-1827 "On a strictly technical level, even if a dispute would divide the board equally precisely along labor and shareholder lines, the chairman of the supervisory board, who is always elected by the shareholders, has a so-called casting vote, whereby he or she may cast a second vote in order to break the deadlock. Although the situations in which the casting vote have been used are quite rare, the shareholder representatives will ultimately prevail over any unified objection of the labor representatives".

¹⁴⁸ Cited above at note 149. p457

¹⁴⁹ Paul L. Davies, *Board Structure in UK and Germany: Convergence or Continuing Divergence?* 18. Available at Social Science Research Network, SSRN: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=262959.

¹⁵⁰Cited above at note 145.

¹⁵¹ Cited above at note 134.p458

¹⁵² Ibid.

forcing a separation between those who manage the day-to-day affairs of the corporation and those who appoint and oversee these managers, resulting in more detached and objective oversight board structure. This system usually operates through a management board chaired by the CEO and composed of entirely of executive members, which is responsible to a supervisory board involving largely or exclusively of non-executive and independent board members.¹⁵³ Further such board would play a vital role to act as breakwater for corruption. The type of corruption experienced by Enron would be less likely to occur in a corporation with a two-tier board structure¹⁵⁴ because the executives would not get the chance to “calibrate, mark and outline on their own assessment papers”.¹⁵⁵ Thus, the independence of the board would result in monitors that are more motivated and able to contest the managers of the corporations. At the same, the system upholds check and balances on those responsible for managing the company. In some jurisdictions for instance, Germany law which frequently refer to as a model for two tier-structure dictates that supervisory board members are not simultaneously a member of the management board, but as an alternative to have monitor and control the members of the management board.¹⁵⁶

In addition, the diffusion of power created through the two-tier structure will assist in the mediation of conflicts, allow access to superior response from stakeholders,¹⁵⁷ and enhances the integrity of the company governance.¹⁵⁸ The two-tier board governance would bring additional benefit of providing a long-term outlook without constricting deal-making, entrepreneurial talents, or the ability of the management board to track the company.¹⁵⁹ Even if the two-tier model have its own strength through the governance of company is not free from criticism.

A frequent criticism of a two-tier board structure is being bureaucratic and not having a well-organized decision-making process and it also enables some manipulations by the management board, since the latter basically provides most of the information upon which the supervisory

¹⁵³ Richard Westlake, Guidance for the Director of Banks: IFC Global Corporate Governance Forum Focus 11, (IFC, 2013), p29

¹⁵⁴ Cited above at 132.

¹⁵⁵ Ibid.

¹⁵⁶ Christian Lazar et al, Remuneration of Non-executive Directors in German Listed firms: An Empirical note; HHL Research Paper Series in Corporate governance, No. 12, (may 20, 2013), p3

¹⁵⁷ Comparative Study of Corporate Governance Codes Relevant to the European Union and its Members (January 2002), p4–5 cited in Jean Jacques du Plessis et al, p88

¹⁵⁸ Martin Schulz and Oliver Wasmeier, The Law of Business Organizations: A Concise Overview of German Corporate Law, (Germany, Springer, 2012), p41

¹⁵⁹ Ibid.

board's decisions are based.¹⁶⁰ Similarly, the two-tier system might endure from cruel rigidity and a rather remote form of control.¹⁶¹ In other words: separate legal bodies for executive and non-executive managers may well amplify the irregular distribution of information between both, worsening the inherent principal-agent-problem.¹⁶² In contrast to that, a high degree of impartiality and a clear division of the separate duties of the two organs can be ascribed to the two-tier board system, which is based on the idea of having an autonomous management board and a supervisory board. Moreover, the supervisory board is also every so often dependent on the management board, especially as far as acquiring relevant and updated information is concerned.¹⁶³

4.3. The Desirability of Adopting the Two-Tier Board Structure as a Solution to the Problems in the Ethiopian Share Company Corporate Governance.

As it has been said previously, the inclusion of a supervisory board within corporate management systems has been endorsed and adopted by different jurisdictions. In addition, different scholars also argue in favor of the system by providing several possible benefits it can bring to share companies as well as to the overall economy of a country. As part of the international community and in addressing the current problems, introducing supervisory board directors in the governance of Ethiopian share companies would bring the following benefits.

Firstly, when we see companies established in Ethiopia that are composed of a dual board structure their core value is not only going to be addressing the interest of the company and shareholders but it goes further to stakeholders' problems. A stakeholder theory argues for corporations to consider the interests of stakeholders who may be individuals or groups that can be affected by the company's activities.¹⁶⁴ Stakeholders, in one or another way, voluntarily or obligatorily, contribute something to the capital, values or activities of companies and hence are either the beneficiaries or risk bearers.¹⁶⁵ The same is true for companies because they may not be able to create capital, enhance their values, and continue functioning without stakeholders. So, it is argued that

¹⁶⁰ Ibid.

¹⁶¹ Comparative Study of Corporate Governance Codes Relevant to the European Union and its Members (January 2002), p4–5 cited in Jean Jacques du Plessis et al, p88

¹⁶² Cited above at note 131.p41

¹⁶³ Cited above at note 158.

¹⁶⁴ R. Edward Freeman, Andrew C. Wicks and Bidhan Parmar, "Stakeholder Theory and The Corporate Objective Revisited," *Organization Science*, Vol.15, No.3(May-June 2004), p.365. See also Michael C. Jensen, "Value Maximization, Stakeholder Theory, and the Corporate Objective Function," *European Financial Management*, Vol.7, No.3(2001), p.299

¹⁶⁵ Charles W.L. Hill and Thomas M. Jones, "Stakeholder Agency Theory," *Journal of Management Studies*, Vol. 29, No. 2 (1992), p.133

companies have to pay attention to these individuals and the public at large and for that matter, introducing supervisory directors enables boards to consider and look at the issues of stakeholders around the table as well as ensure companies to continue functioning. This could be for two reasons. First, stresses on the fact that stakeholders have intrinsic value in the company and hence companies have the responsibility to satisfy their valid claims and, addressing stakeholders' claims increase the profitability of the business entity.¹⁶⁶

Secondly, the inclusion of a supervisory board within a board of directors would help companies to enhance their performance.¹⁶⁷ Companies have their own goal and objectives, and to accomplish such paradigms, they could have the support of those individuals or groups who can highly affect companies and know how the operation of the company can affect theirs. Hence, enabling them to understand their relationships, significance then bringing them to the boards, facilitate both boards of directors to work together in attaining companies' objectives and ensuring their continuing survival.¹⁶⁸ It also can diversify the major aims of boards which are making shareholders wealthy; rather, it qualifies them to wide there scope to multiple relationships, objectives (involving stakeholders), and ensuring long term success.¹⁶⁹ Moreover, introducing supervisory directors increases the quality and performance of boards as well as companies.¹⁷⁰ Jirata Nemera has the opinion that introducing such schemes is vital and it would help to improves the performance of boards in a certain sectors.¹⁷¹ As we know the primary function of boards is to monitor and supervise the engagements of managers to ensure that companies are running according to shareholder's interests. However, their effectiveness may vary on the basis of the degree that boards' members are dependent on the company. Boards that are primarily composed of members (shareholders) may be reliant on companies and thereby ineffective because of their strong link with the organization whereas boards primarily composed of supervisory directors are thought

¹⁶⁶ Ibid.

¹⁶⁷ Prashanth Beleya, "Independent Directors and Stakeholders Protection: A Case of Sime Darby," *International Journal of Academic Research in Business and Social Sciences*, Vol.2, No.4(2012), p.425

¹⁶⁸ Gebeyaw Simachew Bekele, *A Critical Analysis of the Ethiopian Commercial Code in Light of OECD Principles of Corporate Governance Framework (2011-2012, Unpublished, Library, School of Advanced Study, University of London)*, p.18 and p p.33-34

¹⁶⁹ Ibid.

¹⁷⁰ Sajid Hussain Awan and Aamir Khan, "Effects of Board Composition on Firm's Performance: A Case of Pakistani Listed Companies," *Interdisciplinary Journal of Contemporary Research in Business*, Vol. 3, No.10 (2012), pp. 859-60

¹⁷¹ Interview with Ato, Jirata Nemera Manager at Ministry of Trade department of Trade licensing and registration, , April 28 2020.

effective in monitoring managers because their incentives may not be negotiated by reliance on companies.¹⁷²

Thirdly, the supervisory board of directors can play a significant role in mitigating the efforts of searching for and forming confirmation bias among directors which we can see in practice as one of gigantic problem in share companies this days in Ethiopia as it's been stated in the above sup-topics.¹⁷³ However, having supervisory directors on boards diminishes this tension because it is composed of directors who have diverse views and sets of values leading importance to enrich the quality of decisions of boards. This is because in diversified boards, there are unique views and hence it is not easy for directors to initially agree or engage in the biased search process. In fact, confirmation bias is the observed inclination of group members to seek information that confirms their priory opinions.¹⁷⁴ Thus, boarding the board members would help to enhance the quality of the boards' decision. It also makes boards less likely to be overconfident.¹⁷⁵ Further adding such directors will improve the quality of decisions of boards on matters which are complex, which require creativity and judgment.¹⁷⁶ Jirata Nemera argues that introducing supervisory directors on Boards of share companies is circular and enhances the decision of boards.¹⁷⁷ In heterogeneous boards, there is cognitive conflict, i.e. member directors are with different backgrounds so that they bring in different conflicting ideas, views, and knowledge that capacitate boards to see problems and challenges from different perspectives, alternatives viewpoints, and indifferent arrays of interpretations.¹⁷⁸ So, these circumstances improve the quality of thinking of boards.

Furthermore, as we have seen in the above topics, most of share companies in Ethiopia practically and theoretically ducked in one-board by molding all major roles i.e. the controlling, strategy planning and service role. Moreover, the law doesn't give any legal position for non-executive's at least theoretically which makes the matter more complicated. Judge Ashenafi Lemecha stated

¹⁷² Cited above at note 168, p.5

¹⁷³ Ibid.

¹⁷⁴ J. Edward Russo, Victoria Husted Medvec & Margaret G. Meloy, The Distortion of Information During Decisions, 66 *org. behavior & human decision processes* 102 (1996) cited in Lynne L. Dallas, cited above at note 115, p.28

¹⁷⁵ Ibid.

¹⁷⁶ S. Barsade, et al., To your heart's content: A model of affective diversity in top management teams, 45 *Administrative Science Quarterly*, (2000); cited in Frank Dobbin and Jiwook Jung, "Corporate Board Gender Diversity and Stock Performance: The Competence Gap or Institutional Investor Bias?", p.4. Accessed at http://www.wjh.harvard.edu/~dobbin/cv/workingpapers/Board_Diversity_and_Performan. visited on April 13, 2020.

¹⁷⁷ Interview with Ato Jirata Nemera, cited above at note 183.

¹⁷⁸ Donald C. Hambrick, et al., The Influence of Top Management Team Heterogeneity on Firms' Competitive Moves, 41 *Administrative Science Quarterly*, (1996) cited in Frank Dobbin and Jiwook Jung p.5

that most of the cases recently coming to the court are related with under performance of directors on their duties, which at the end also makes the issue tough for judges as the matter is not clearly stipulated both in the MOA and the law. Accordingly, introducing the two-tier structure on the other hand involves a dual board organization, in which the management board handle the strategy and service role while the supervisory board enrolls the controlling role, Which stretches a clear separation of legal responsibilities and legal liabilities of executives and non-executive's directors and this could be one of the benefits that we may encounter that can mitigate to solve the practical changes that we are facing in courts this days. This system could also decrease the loads of cases coming to courts.

In addition, companies that are composed of supervisory directors are well-organized in forming good relationships between boards and companies, diverse employee populations, shareholders, and other individuals and corporate communities.¹⁷⁹ They also provide passive attention to diversify issues and create a climate in which all members of companies can work effectively. Otherwise, if we don't provide a suitable framework for the existing problems the turnover, miscommunication, and interpersonal conflicts may further bring poor productivity in companies, and eventually, it will result in lower performance on profit, market share, or other tactical goals of the company. Boards composed of supervisory directors comprehend the diversity and worries of its various employees, shareholders, or other individuals and groups and are likely to facilitate the adoption of different policies and strategies which rises their satisfaction.¹⁸⁰They boost companies' ability to work with these diverse groups or individuals which in turn leads to greater productivity and profitability of firms.¹⁸¹They also develop the social capital and social cohesion of those communities.¹⁸²

¹⁷⁹ Martha A. Gelekaney and Donald C. Hambrick, "The External Ties of Top Executives: Implications for Strategic Choice Performance," *Administrative Science Quarterly*, Vol. 42, No.654(1997), p.662

¹⁸⁰ Ibid.

¹⁸¹ Ibid

¹⁸²Stefaanescu Cristina Alexandrina, "How do Board of Directors Affect Corporate Governance Disclosure? -The Case of Banking System," *The Romanian Economic Journal*, year XVI, No.47(march, 2013), p.130. See also Anis Mnif, "Corporate Governance and Management earnings Forecast Quality: Evidence from French Ipos" (February, 2020), pp. 5-6. Accessed at <http://hal.inria.fr/docs/00/45/91/71/PDF/p61.Pdf> on visited March 30,2020

4.4. Prospects and Challenges of Introducing the Two-Tier Board of Directors in The Governance of Ethiopian Share Companies

Though the idea of having a dual board of directors is not introduced yet, there are certain factors that would facilitate and encourage its introduction in Ethiopia. Hereafter we will see some of the prospects and challenges that may result from introducing a two-tier board of directors in the governance of Ethiopian share companies.

First, in the last couple of years Ethiopia has been visualizing reforms like the adoption of a market economy, privatization of state-owned enterprises such as telecommunication, sugar industries, electric power supplying sectors with some exceptions, and also liberalization of the financial sector to private domestic and foreign investors.¹⁸³ To that effect, we are observing that several share companies are being formulated. In addition, it has been experienced that numerous people are buying stocks and becoming owners of different share companies.¹⁸⁴ Hence, these days, separation of ownership and control of share companies is emerging in the country. Share companies are nowadays managed by directors and other executive officers, and agency problems and other corporate governance issues are becoming unavoidable. In addition, Ethiopian share companies are surrounded by a number of corporate problems such as combination of politics and business, absence of share markets, scarcity of shareholder protection laws, unproductive court system,¹⁸⁵ poor competitive environment,¹⁸⁶ insufficient risk management system,¹⁸⁷ etc. As a result, the prevalence of these corporate problems urges Ethiopians to search for efficient solutions to tackle the existing problems. Several researches and best practices on the globe show, introducing a two-tier board of directors on the current boards is a wise solution. Further, the capacity, as well as the size of share companies is also being strengthened.

Secondly, as aforesaid the country has also been attracting foreign investors to come and invest and has promised to provide different protections and incentives. For instance, the government

¹⁸³ Asamnew Techan Demeke, "Corporate Governance Mechanisms and Firm Performance: The Case of Ethiopian Insurance Industry," *Journal of Investment and Management*, Vol. 5, No. 2, 2015, pp. 6

¹⁸⁴ For instance; Hiber Sugar S.C, Ethio Sugar S.C and Goh Betoch Bank under formation. Can be cited

¹⁸⁵ Tessema, A.2003. Prospects and Challenges for Developing Securities Market in Ethiopia: An Analytical Review. *R & D Management*, 15(1), p.51 cited in Asnakech Getenet Ayele, "Revisiting the Ethiopian Bank Corporate Governance system: A Glimpse of the Operation of Private Banks," *Law, Social Justice & Global Development Journal* (2013). P. 27. See also Minga Negashe, "Rethinking Corporate Governance in Ethiopia," *Journal of Economic Literature*, No. K12, K22, L22, M14, M41, N27 (2008), p.2

¹⁸⁶ Seyoum Yohannes' "on Formation of a share Company in Ethiopia" *Journal of Ethiopia*. Vol22 No.1 page 107

¹⁸⁷ Ibid

adopted different laws and ratified international conventions and documents.¹⁸⁸The government promised to conclude the WTO accession process by the end of 2021.¹⁸⁹ These activities show the country is opening its economy to foreign/international business actors. So, the status quo by its self is pushing Ethiopia to introduce a standardized and diversifying roles of the board of directors system by taking best theories, and international experiences that take in to account the inclusion of supervisory board in order to establish good corporate governance system in our share companies and capacitate them to be competitive, profitable and move them for having obsolete thinking of so-called accountable for shareholders only changing to towards corporate social responsibility to stakeholders.

Finally, though it did not happen in Ethiopia so far, the collapse of Enron, WorldCom, Tyco, Adelphia, etc. and the recent financial crisis that has emerged on the globe put several countries to learn about the serious consequences of weak corporate governance problems. Thus, Ethiopia has to learn from these incidences and make itself ready, *inter alia*, by introducing a dual board of directors on boards of share companies for the future, because it has no assurance that financial crisis would not happen in Ethiopia in the upcoming periods. Encompassing boards with supervisory directors is also one way of showing good corporate governance.

On the other hand, there are also factors that challenge the introduction of a two-tier board of directors in the governance of Ethiopian share companies.

To begin with, within the history of corporate governance of Ethiopia, share companies are used to be represented by shareholder-directors. This has worked for over half of a century and the business communities, as well as individuals, are usual to it. It is difficult to break this system. Thus, introducing executives' supervisory boards within the composition of shares may not be welcomed particularly by rent-seeking official officers, directors as well as squares shareholders of share companies. Typically, since supervisory executives will prevent them from their sharking and other wrongful exercises and guarantee companies to be worked within the interface of all shareholders and partners. Assist, due to its originality, presenting the supervisory board of

¹⁸⁸For instance ; the country signed the African Continental Free Trade Area(ACFTA) on <http://www.ena.gov.et/en/index.php/economy/item/4452-ethiopia-43-countries-sign-african-continental-free-trade-agreement> last accessed march 23th,2020. In addition, the government is amending different laws such as the new investment bill that has been approved by the parliament on 30 January 2020 by repealing the Investment Proclamation No. 769/2012. Which is showing one way the government paving the way for new investments.

¹⁸⁹ https://www.wto.org/english/news_e/news20_e/acc_eth_31jan20_e.

directors' shareholder executives may not be indeed effectively acknowledged by shareholders, endorsed by the assembly, and interpreted well by courts of law. The other is in connection to not seeing it as unreliability or prioritizing it with the current board of governance structure. There are also scholars and executives that disinterested with the introduction of such schemes. In fact, these persons do not disregard the advantages that would be gained by the system. But they feel more suitable with the existing system. W/ro Feven argues that having an independent directors' system is still debatable on the globe.¹⁹⁰ Further, she resists that due to their separation with regard to their performance it may further harm the existing workflow of the company, as a result, it's not wise to introduce such a system.¹⁹¹ And also add "it's the answer to the question you didn't ask but should have": introducing a certain qualification scheme for directors could solve almost half of the share companies problem that we are facing. This is because just a person has the potential to invest or having interest in share in a company cannot guaranty us s/he has the expertise that take how the business is running. As a result, to have a welcoming and to have unvarnished decision companies board of directors should hold a vacuum for certain expertise on their boardroom to rich the ultimate goal whatever the company aimed.

4.5 Matters that Needs Consideration in Introducing Two-Tier Board of Directors in Governance of Share Companies in Ethiopia

The first focus has to be providing a Liability and mandatory qualification standard of supervisory boards of companies. As it has been stated in the above sup-topics members of the supervisory board have a demanding and important responsibility role, as shareholders and other stakeholders do not have the ability to efficiently monitor the management themselves, they rely on their work. In different legal jurisdictions, supervisory boards are liable to the corporation for any breach of their duties.¹⁹² They also make possible for shareholders to bring any kind of legal action against the members of the supervisory board, yet, numerous requirements have to be fulfilled.¹⁹³ However, it would be even more advantageous if the shareholders themselves were able to bring any legal action to the members of the supervisory board responsible for ineffective control of the

¹⁹⁰ Ato Ashenafi Lemecha judge at Federal First Instance Arada Court (Commercial Bench)

¹⁹¹ Ibid

¹⁹² According German Stock Corporation Act of 1965, Sec. 116 "members of the supervisory board are held liable to the corporation for any breach of their duties".

¹⁹³ Germany Corporate Integrity and Modernization of the Right of Contestation Act of 2005 (Gesetz zur Unternehmensintegrität und Modernisierung des Anfechtungsrechts (UMAG) (22 September 2005, BGBII 2802). See also: Carsten Jungmann, "The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board System," European Company and Financial Law Review 3, no. 4 (December 2006): page 426-474.

company. In such pattern the company would not necessarily have to suffer a loss; the ridicules suffered by the shareholders would be sufficient. The other point that needs attention would be the introduction of mandatory qualification standards for supervisory boards to enhance the quality of corporate control. Such necessities should be applicable for all members of the supervisory board in order to assure a uniform level of efficiency. In any case, diversity of experience and knowledge is beneficial for the work of the supervisory board. Thus, it is neither necessary nor desirable for the supervisory board to consist solely of experts in business administration, corporate finance, or the like. Expertise in the relevant sector, practical knowledge, access to important external information, good business relations, etc. would also serve as evidence of qualification. Only a board that involves a person who, have the know-how to fulfill the necessary level of supervision over the company, serves as an effective means of control. For instance, the NBE provided mandatory requirements for directors to fulfill in order to be selected or appointed as a director.

The other point that needs attention is the inclusion of supervisory boards more involvement in management decisions. This does not mean that the separation of management and control in the two-tier system should be abolished. Day-to-day management should remain the responsibility of the management board. Certainly, there are insignificant differences between the daily duty of the members of the management board and the seasonal responsibility of the members of the supervisory board to evaluate plans, decisions, and results. The supervisory board should not be entirely restricted to an *ex-post* control. Thus, all essential decisions and especially those that set or change the corporate strategies should require the endorsement of the supervisory board.¹⁹⁴ This proposed mandatory approval list is more than a mere expansion of the existing legal rules: it should be seen in the context of the above-mentioned professionalization of the supervisory board as an organ consisting of experts permanently monitoring the company. In such a reformed supervisory board the flow of information is more complete and timelier, and due to the higher regularity of meetings, decisions can obtain the necessary approval within a reasonable time.

¹⁹⁴ Ibid.

Chapter-Five

5. Conclusion and Recommendations

From the above-stated discussions, the writer would draw the following conclusions and recommendations.

5.1 Conclusion

The first issue raised by this research paper is: -

1) To analyze the legal position and challenges of Ethiopian share company corporate governance.

In general circumstances, it is believed that the Board of directors play a crucial role in governing, directing, controlling, monitoring, overseeing all activities, some labeled them as integral part of Share Companies. Accordingly, if the board does not invest sufficient time and effort to paradigm effective policies and strategies and keep it under regular review, all the efforts of management and employees will not produce optimal results, if not impossible at all. Directors are expected to act in the legitimate interest of the Company, shareholders, and other stakeholders at large, though the practice is the reverse.

In Ethiopia, the ownership structure of the majority of share companies, in general, is concentrated, whereas there are a small number of share companies with a dispersed ownership structure. However, the problem between shareholders and management arises in all sorts of share companies in Ethiopia, though it is more serious in extent in share companies with a dispersed ownership structure. Poor corporate governance system, shareholders, and other shareholders lack knowledge and enthusiasm to effectively monitor the management, information asymmetry, and poor regulation of the companies by the Commercial Code and other relevant laws. In particular, the board as a monitoring and controlling entity is not effectively set up concerning their role, composition, duties, and liability. Not only that, but it has also been seen under the research that shareholders and other stakeholders don't have a full-fledged power to enforce any kind of legal action against the directors. Alongside disclosure and transparency standards are not well-equipped to convey honest and appropriate information to the shareholders and stakeholders. On top of all this, in practice, the Ministry of Trade and Industry is acting as a toothless lion even if the commercial code and other substantive laws indorse the office to supervise, monitor, and to act on behalf of the rest of stakeholders.

Hence, the research has shown that the quality of the existing corporate governance system is inadequate to meet the problem with equal strength. This may result in a lack of confidence to the public to invest in share companies and it may deprive the actual capacity of the company's role in the overall economy of the country.

The other question of the research was:

2) Should a two-tier board structure be introduced in the Ethiopian corporate governance system?

The response for the first issue raised was that Corporate Governance of non-financial Share Companies Board of directors were not adequately regulated with regard to protecting the genuine interests of the Share Company, shareholders, and other stakeholders and that there is a need for legislation that governs this area. As a result, the paper has seen other countries experiences and came across to the introduction of a two-tier board structure in the current company governance system. With the outcome of providing a solution to the existing major problems as it's been stated in the paper. The demarcations of the boards of director's i.e. Managerial and Supervisory board found to be an interesting concept with regard to the inclusion of the supervisory board as a problem-solving in the current corporate governance of Ethiopian share companies.

However, the pragmatic part of this study led to the conclusion that it is difficult to consider one of the two concurring systems for corporate control as being superior to the other. However, the main takeaway is not that the board of directors of share companies in the non-financial sector should consider adopting a two-tier structure, the takeaway that the study provides for share companies is simple "don't compare repair it". It is to mean that we already have a single level board model in place that has been there relatively longer and it's been tested practically. As a result, it is not advisable to emerge a whole new model. This is because the introduction of an entirely new board structure is less likely to receive a smooth implementation.

Nevertheless, the researcher still believes the incorporation of the supervisory board as it aims not only to protect the viability of the company and shareholders it goes further to protect other stakeholders that have affiliation with the company directly or indirectly. In addition, the research proclaims that the incorporation of the notion could ensure good corporate governance only if a detailed regime is provided for it, and its application should be strictly regulated. In order to do so, the government should take a lesson from various country's experiences with a view of looking for

good corporate governance principles to be implemented for its local needs. Rather than leaping to a shareholder or stakeholder model, the country should determine a system of corporate governance most suitable to her own individual needs and environments. The one thing that has to be understood is that one size does not fit all.

5.2 Recommendation

- One possible recommendation forwarded is that the government should amend the provisions of the Commercial Code relating to corporate governance. In particular, it should come up with a law that formulates a supervisory body for having a separation of ownership and control in the non-financial sector companies. By understanding the existing situation, there is a necessity to be thoughtful that shareholders and other stakeholders may be subjected to manipulation in the hands of corporate managers or block holders.
- The regulatory legal framework should predominantly adopt a mandatory law of corporate governance. As to protect shareholders and other stakeholders from the exploitations and mismanagement of directors and other corporate officers.
- Improving the law with regard to removal of directors and also introducing an effective system of disqualification of supervisory and management board members.
- Introducing a minimum requirement on the competence and personal qualification for both board of directors' body should be required.
- Shareholders should be allowed with the necessary rights to enforce the duties of the directors. In particular, the Commercial Code should adopt the derivative suit mechanism to enable the shareholders to bring an action in their own name or in the name of the company when the two separate boards of directors failed to exercise their duties properly.
- The powers of the Ministry enshrined in the Commercial Code and other relevant laws are not sufficient to effectively regulate and supervise the non-financial share companies that operate in the country. Therefore, the Ministry should be endowed with more powers especially with respect to monitoring and supervising the governance of the companies. More importantly, it should be empowered to impose administrative sanctions against the companies and their managers or directors in a case where there is a deceitful activity or a violation of the law. Moreover, the Ministry should be strengthened with the necessary human capital in terms of expertise and number.

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